

# Japan-EU's Cooperation to Promote Asia's Economic Integration

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# Intra-Regional Trade in Asia

- Economic integration in EA has been led by foreign trade. A notable feature of the region's intra-regional trade is the high proportion of vertical intra-industry trade in intermediate goods.
- This reflects the fragmentation of production process and the expansion of vertically integrated supply chains across the region.
- But the demand for the final goods is heavily dependent on an extra-region, such as EU and the US.

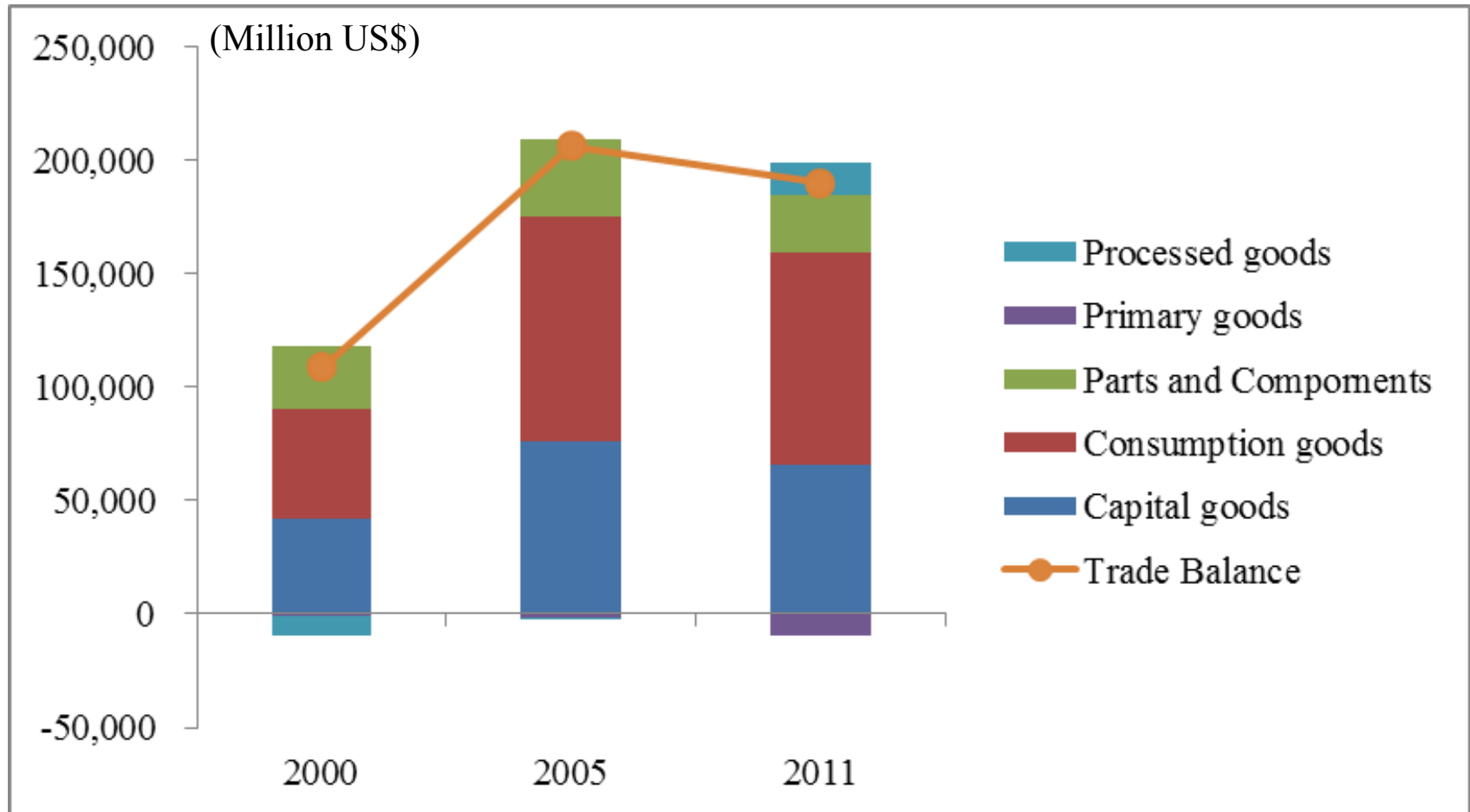
# Asia's Exports by Destination (share; %)

(%)

		East Asia			EU+US		
			Japan	China		EU15	US
Gross Trade	Japan	46.6	-	20.3	29.8	13.2	16.6
	Korea	47.0	6.1	28.3	21.9	9.7	12.1
	China	24.1	8.7	-	43.2	20.7	22.6
	ASEAN6	30.5	8.6	14.1	26.5	13.9	12.7
	EU15	9.6	1.8	3.7	59.6	50.5	9.1
Value- Added Trade	Japan	32.2	-	14.0	38.2	16.9	21.3
	Korea	29.8	7.1	14.9	34.4	15.0	19.4
	China	18.8	8.5	-	46.3	22.3	24.0
	ASEAN6	24.3	10.2	9.2	33.0	16.5	16.6
	EU15	9.9	2.4	3.6	56.9	45.0	12.0

Source: OECD-WTO *Trade in Value Added*

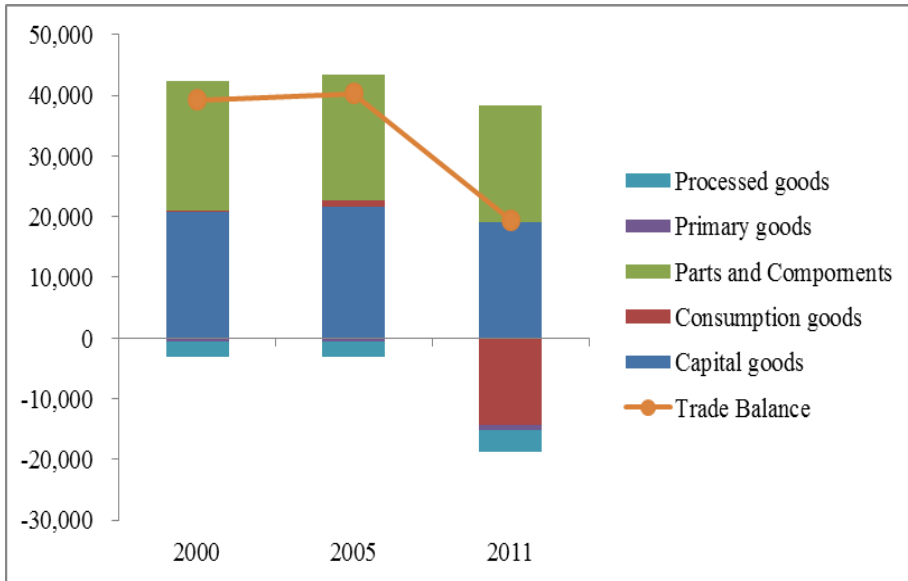
# Asia-EU Trade Balance by Products



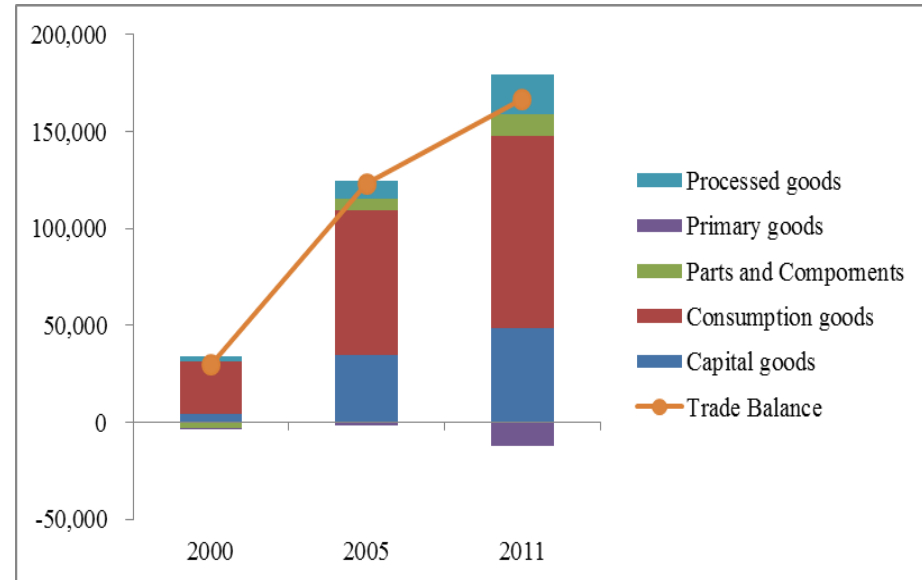
Source: RIETI, Japan *RIETI-TID 2012*

### [Japan-EU]

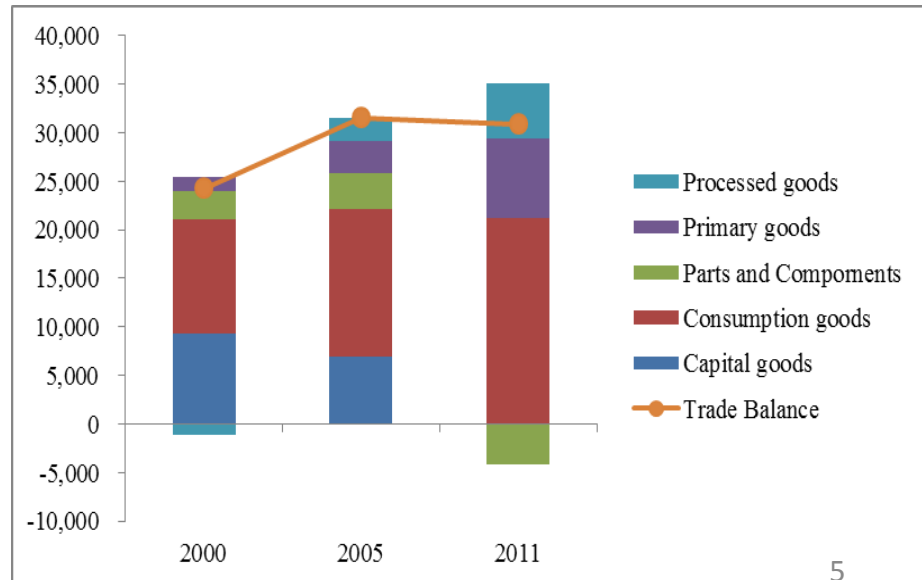
(Million US\$)



### [China-EU]



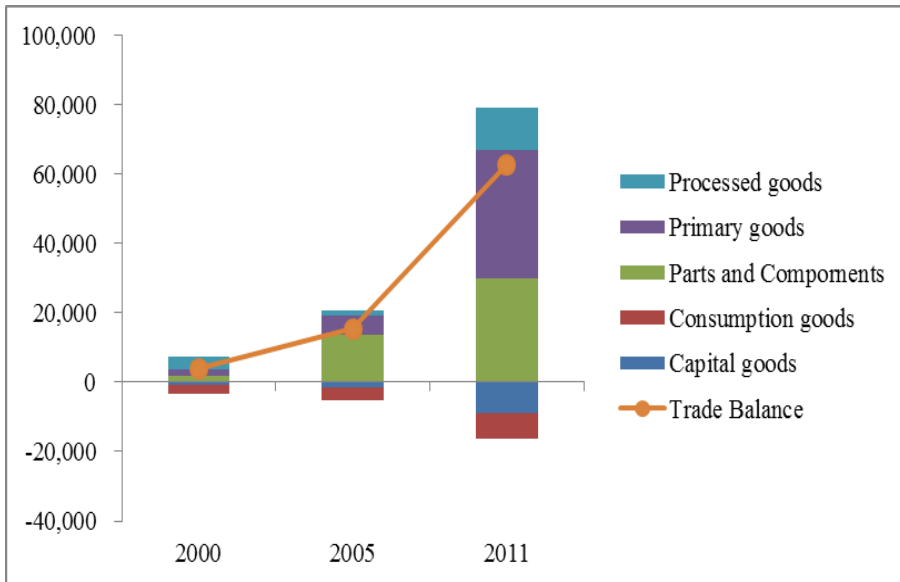
### [ASEAN-EU]



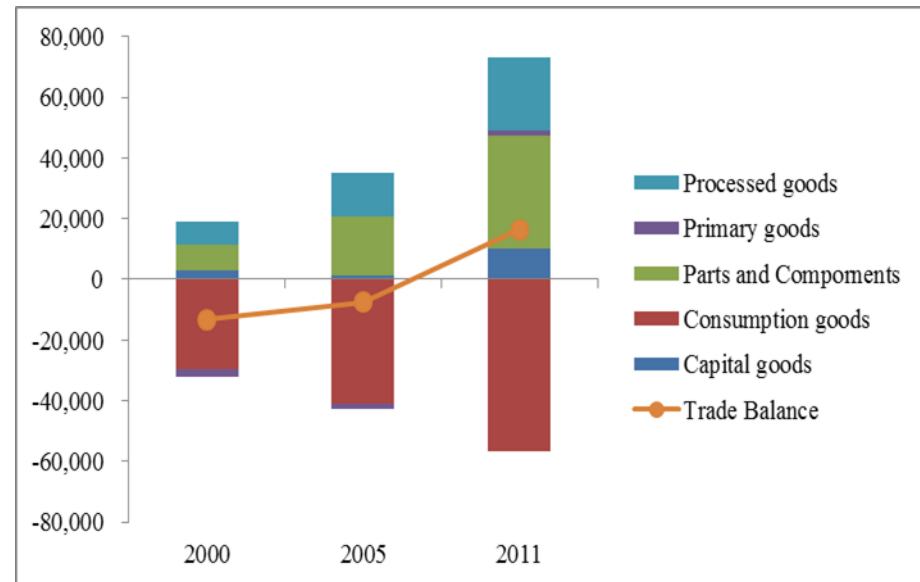
Source: RIETI, Japan *RIETI-TID 2012*

[ASEAN-China]

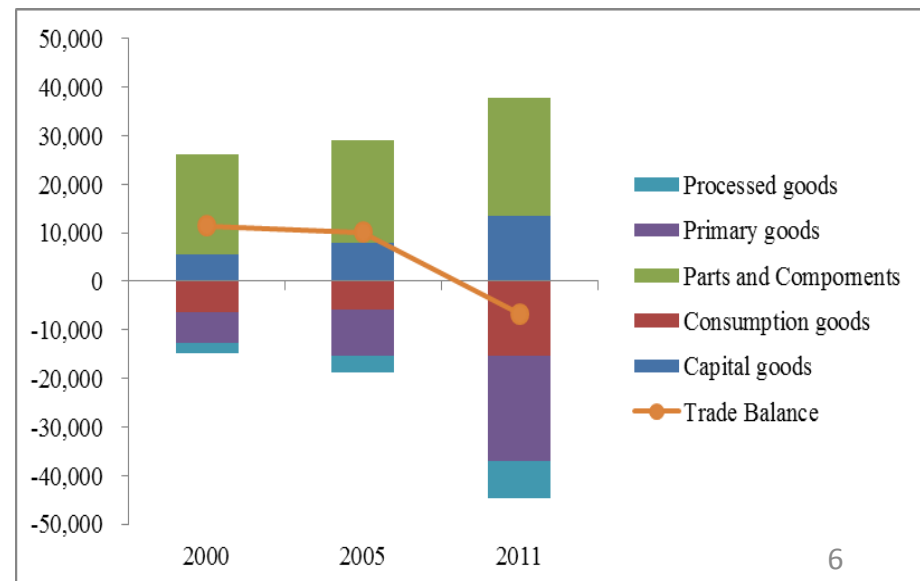
(Million US\$)



[Japan-China]

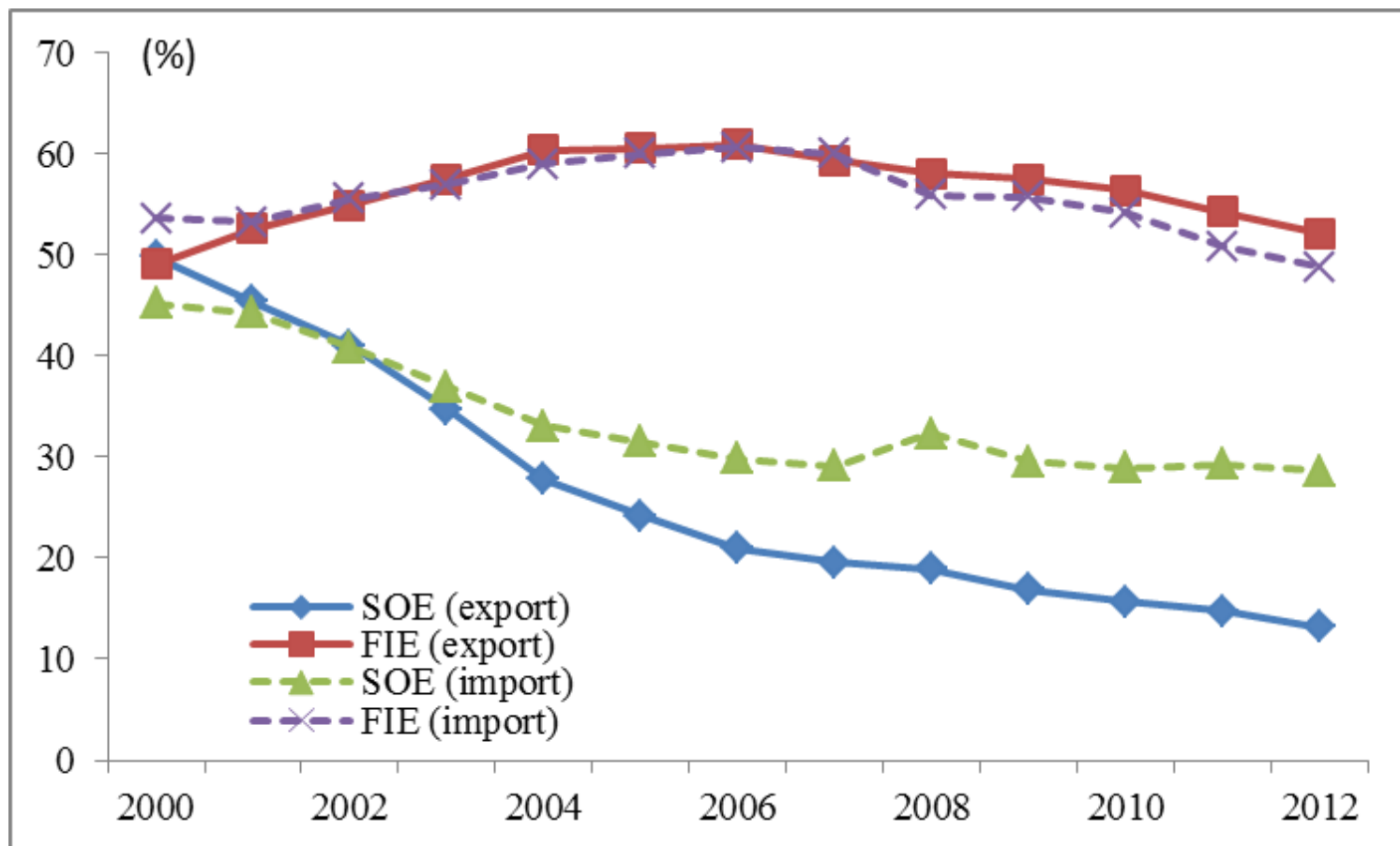


[Japan-ASEAN]



Source: RIETI, Japan *RIETI-TID 2012*

# China's Exports/Imports by Types of Enterprises (share; %)



Source: CEIC Database

# The Challenges to Asia's FTAs

- The significant expansion of FTAs has been observed in Asia since 2000. But Asia's FTAs are patchy, fragmented, and incomplete. Although some of them are comprehensive and liberal, others are less so (Plummer, 2007).
- A region-wide FTA will increase the welfare gain and reduce the cost associated with multiple ROOs in bilateral FTAs (*Spaghetti-bowl effect*).
- It will also create an enabling environment for the extension of supply chains beyond national borders, making the Asian region more attractive to FDI by MNEs.



# FTAs in Asia

	Japan	China	Korea	ASEAN	India	Australia	New Zealand
Japan		△	○*	◎	◎	○	×
China	△		○	◎	△	○	◎
Korea	○*	○		◎	◎	○	○
ASEAN	◎	◎	◎		◎	◎	
India	◎	△	◎	◎		△	△
Australia	○	○	○	◎	△		○
New Zealand	×	◎	○		△	◎	

◎; Effective/Signed, ○; Under negotiation, △; Under feasibility study, ×; No official action

\* JP-KR negotiation is suspended. JP, CN, and KR began trilateral negotiations in 2012.

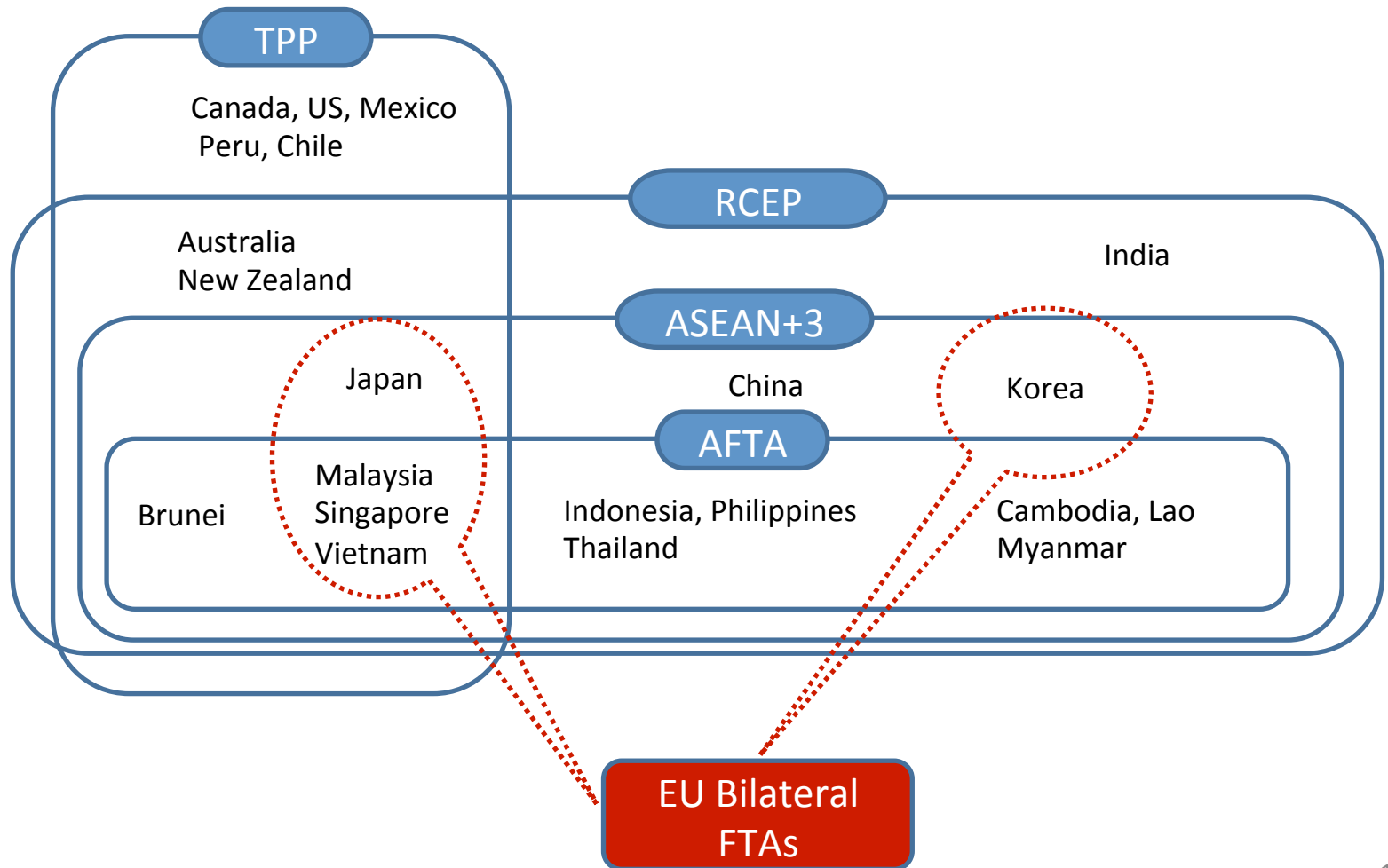
# Coverage of Selected FTAs

		Coverage (%)	
		Goods & Serices	WTO-plus provisions
Japan	JP-Singapore	75	53
	JP-Philippines	69	58
	JP-ASEAN	69	58
	JP-India	69	85
China	CN-ASEAN	81	5
	CN-Taiwan	38	20
Korea	KR-ASEAN	56	5
	KR-Singapore	81	63
	KR-EU	88	85
	KR-USA	100	58
Singapore	SG-EFTA	81	26
	SG-US	56	47
	Traspacific Strategic EPA	75	47
ASEAN	AFTA	44	5

\* WTO-plus provisions include competition policy, intellectual property protection, FDI regulations, and public procurement

Source: Kawai and Wignaraja (2013)

# Region-Wide FTAs

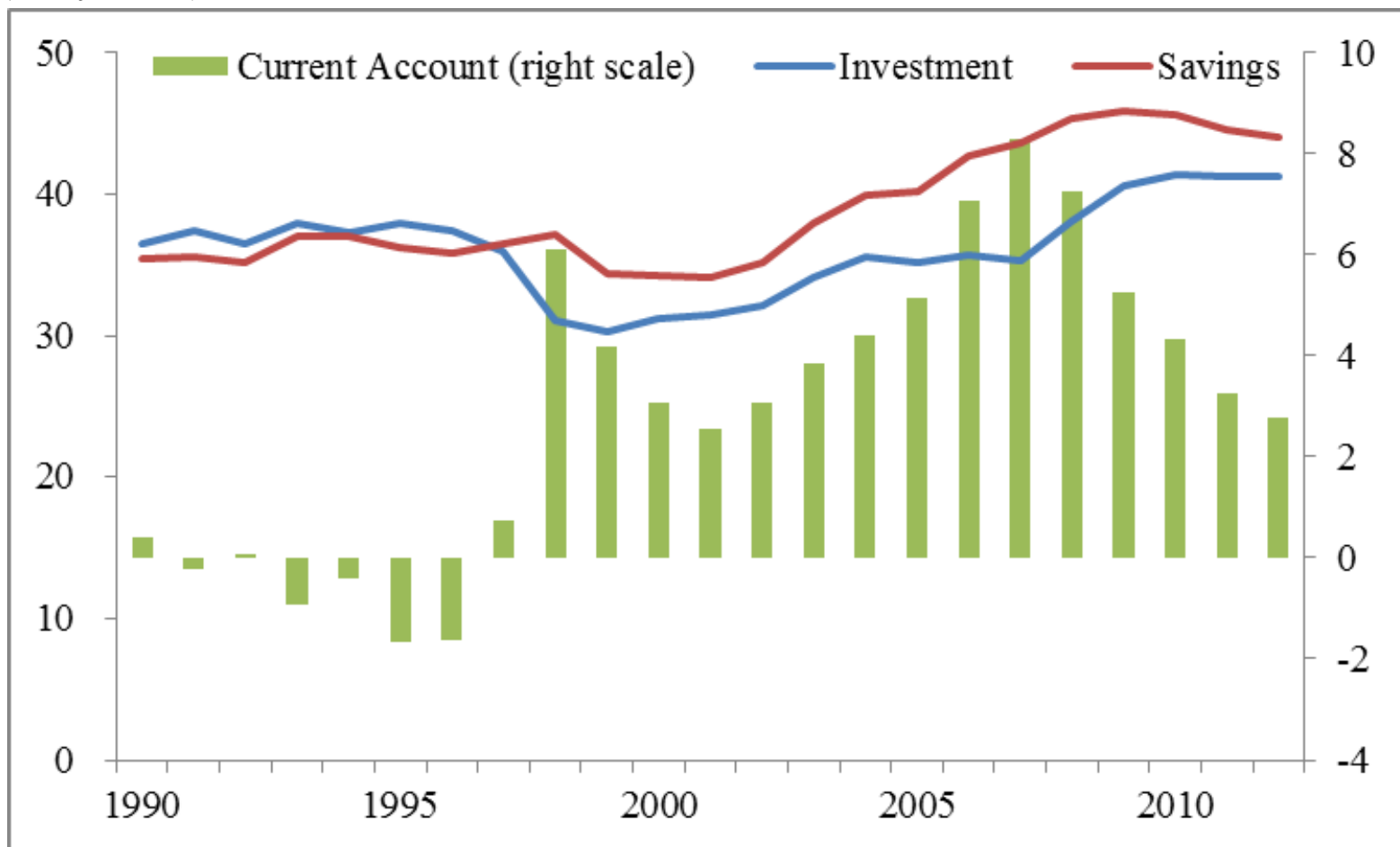


# Catalyst Role of JP-EU FTA

- JP-EU FTA can play a catalyst role for promoting a trilateral FTA among JP, CN, and KR, which is a prerequisite for a region-wide FTA, such as RCEP.
- JP-EU should aim at reaching a high standard agreement in terms of scope and depth, which would provide a benchmark for RCEP.
- JP-EU and KR-EU FTA can be the building block for a future trans-regional agreement between Asia and EU.

# Savings & Investment in Non-JP Asia

(% of GDP)



Note: Asia includes China, Hong Kong, Korea, Indonesia, Malaysia, Philippines, Singapore, Thailand, and Vietnam.

Source: IMF, *International Financial Statistics*

# Asia's Underdeveloped Capital Markets

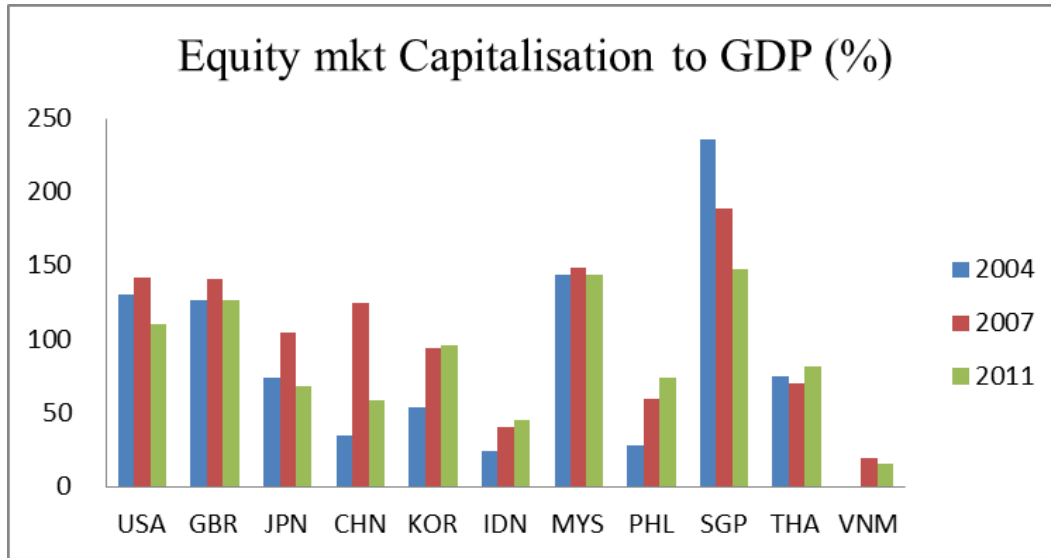
- Asian countries are unable to channel surplus saving into domestic investment presumably due to underdeveloped capital markets
- Asian countries rely on external funding to finance development, increasing their vulnerability to external shocks.
- A well-developed capital market is indispensable for sustaining development and avoiding 'middle-income trap'.

# Asia Needs

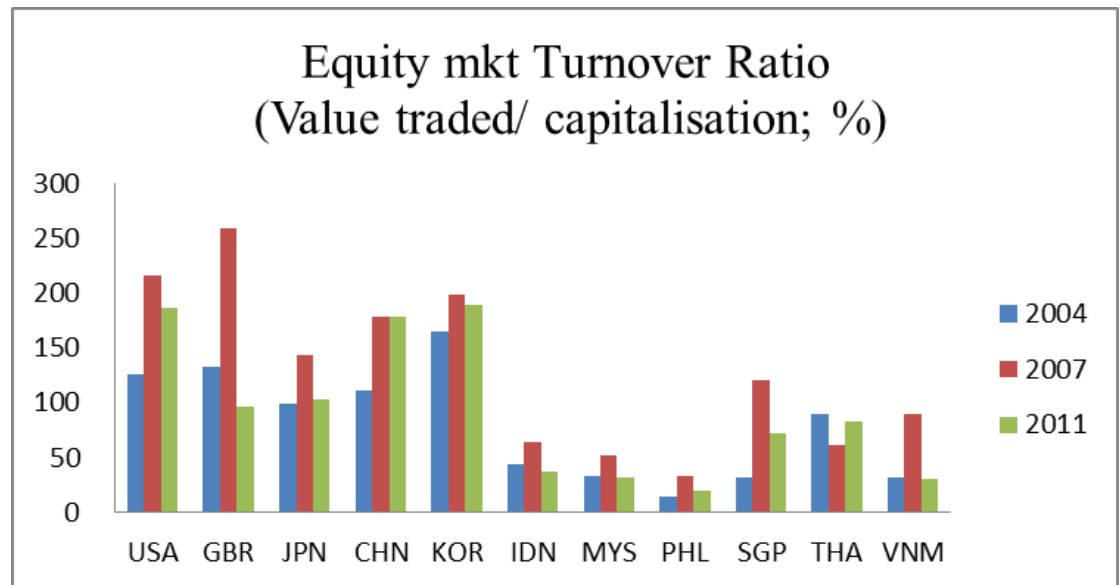
## Deep & Liquid Capital Markets

- Limited market liquidity is one of the key challenges facing Asian capital markets.
- Deep and liquid capital markets can not only better absorb external shocks, but also serve as a spare tire in the event of severe disruption to the bank financing channel (*Felman et al., 2011*).
- Greater foreign participation in domestic markets will lead to better price discovery and less price volatility (*Prasad and Rajan, 2008*).

# Asia's Equity Market Liquidity



Source: World Bank  
*Global Financial Development*





# Domestic Institutional Investors

- Broadening the base of DIIs will help to improve market liquidity in Asia.
- There is a substantial scope for increasing the coverage of pension and insurances.
- Regulations on the investment of DIIs are generally conservative, limiting the scope for diversifying investment allocations.
- The government can promote the development of DIIs by adopting international best practices for these regulations.

# Institutional Investors in Asia

	Life insurance premium volume to GDP (%)		Mutual fund assets to GDP (%)		Pension fund assets to GDP (%)	
	2007	2011	2007	2011	2007	2011
Japan	6.6	*7.1	16.4	12.7	23.8	*23.7
Korea	7.7	7.2	31.4	20.3	3.9	*3.9
China	1.7	2.1	12.4	4.6	-	*0.7
Indonesia	1.1	*1.1	-	-	2.2	-
Malaysia	3.1	2.9	25.3	28.3	47.8	-
Philippines	1.1	0.9	1.4	1.1	-	*3.5
Singapore	5.8	5.2	-	-	51.0	*60.0
Thailand	2.3	3.1	18.8	-	5.2	*5.7
Vietnam	0.8	0.6	0.3	-	-	-
United States	4.0	3.7	82.0	77.6	77.0	69.2

Source: World Bank *Global Financial Development*

\* Data for 2010

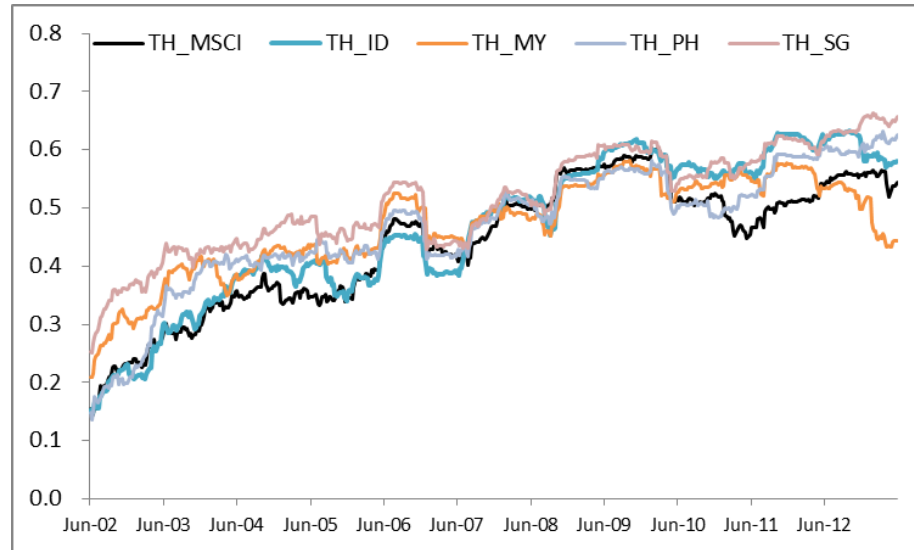
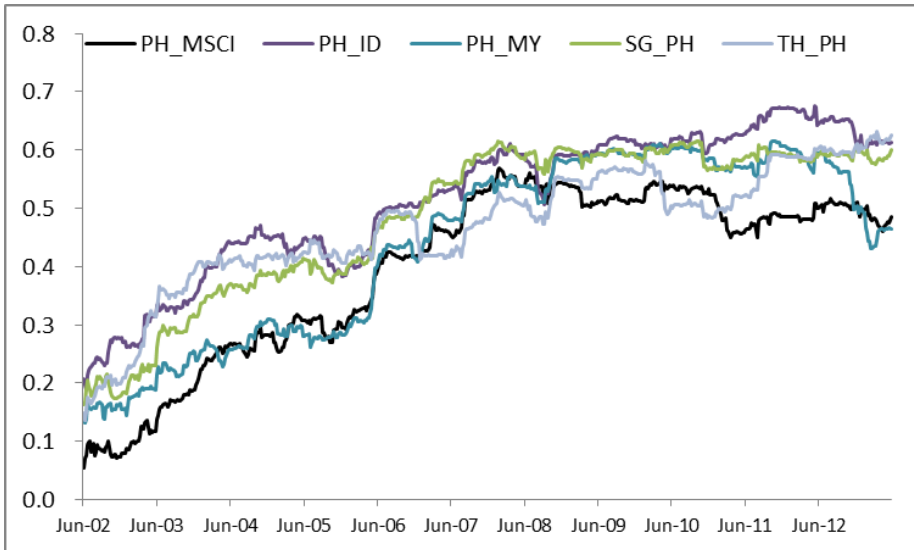
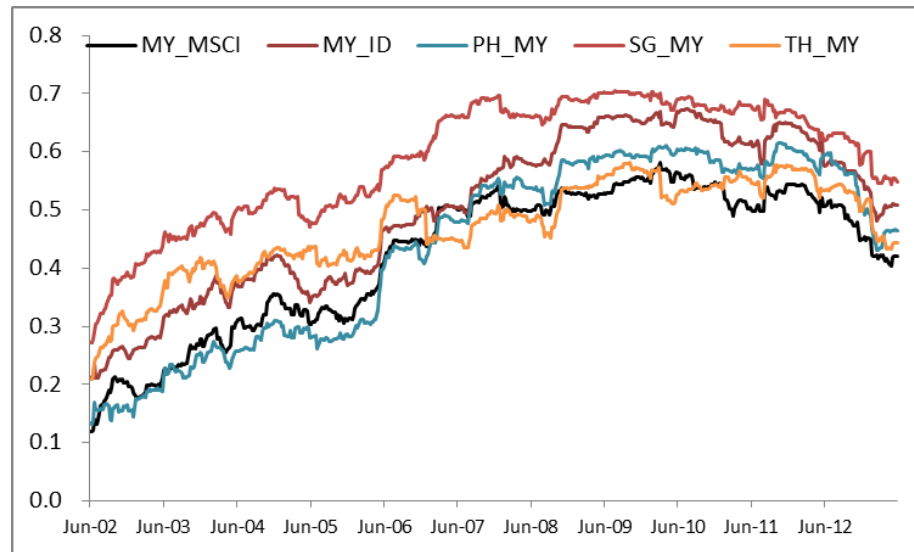
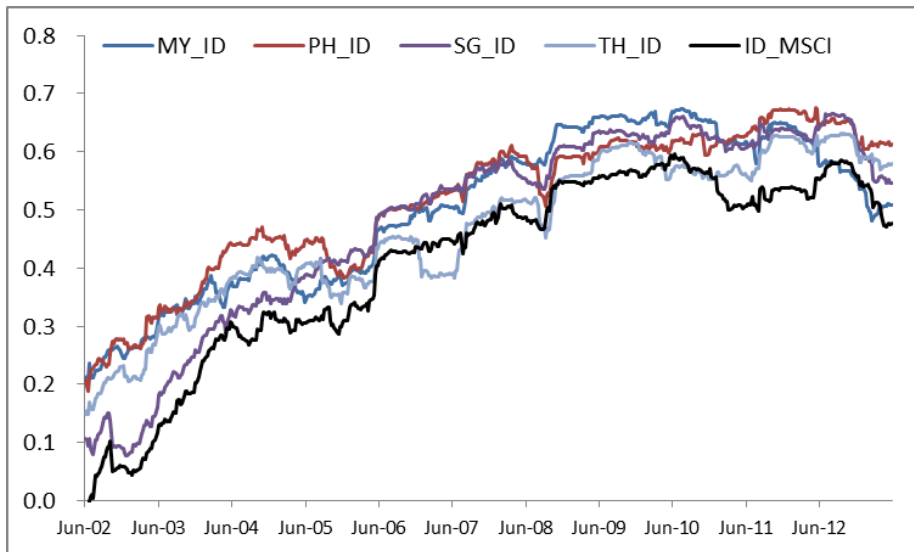
# Challenges to ASEAN Capital Markets

- The capital market in the ASEAN countries are individually small and liquid
- Consequently, transaction costs are high, the varieties of products and services are limited, and the investor base remains narrow.
- Greater access to foreign investors and issuers through market integration will increase the liquidity of domestic markets and broaden the range of products and services.

# ASEAN Capital Market Integration

- AEC Blueprint 2015: A single market with a free flow of goods, services, investments, and skilled labors, and a freer flow of capital.
- In 2009, ASEAN finance ministers endorsed the Implementation Plan to promote the development of an integrated capital market.
- The plan intends to create an enabling environment for cross-border access by promoting the mutual recognition and harmonisation of local regulations and standards.

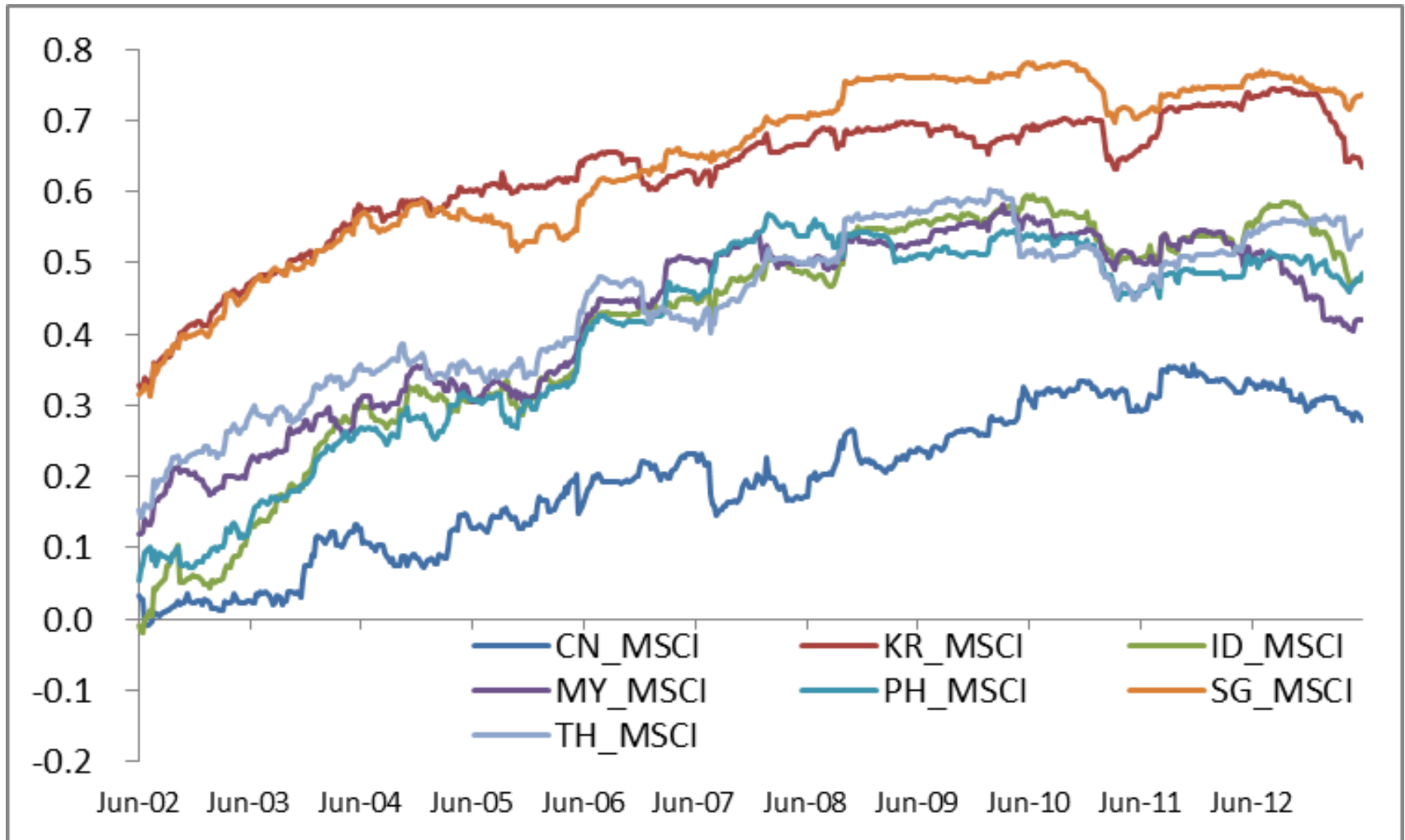
# Intra-ASEAN Equity Return Conditional Correlations



Source: Reproduction of Kinkyo & Hamori (2013) using updated data.

# Asia's Equity Returns

## Conditional Correlations with Global Markets



Source: Reproduction of Kinkyo & Hamori (2013) using updated data.

# Asia's Portfolio Equity Investment by Destination/Origin (share;%)

## Equity Assets

		Investment in					
		Asia		Others	Euro	UK	USA
			Non-SG_HK				
Investment from	Indonesia	16.4	3.4	83.6	2.0	0.1	24.6
	Malaysia	46.6	12.7	53.4	6.0	6.5	21.6
	Philippines	4.0	1.1	96.0	11.7	4.3	68.5
	Singapore	45.1	36.5	54.9	6.2	8.1	15.8
	Thailand	16.9	6.0	83.1	31.0	1.0	16.6
	Korea	33.2	22.3	66.8	17.4	6.1	21.7
	Hong Kong	29.8	28.7	70.2	6.2	12.8	4.2

## Equity Liabilities

		Investment from					
		Asia		Others	Euro	UK	USA
			Non-SG_HK				
Investment in	Indonesia	11.1	3.8	88.9	22.0	9.3	38.0
	Malaysia	26.0	2.7	74.0	18.9	11.8	31.9
	Philippines	9.7	2.3	90.3	19.9	10.7	53.2
	Singapore	12.3	8.0	87.7	17.9	12.8	44.8
	Thailand	15.3	3.3	84.7	25.9	13.3	32.9
	Vietnam	52.2	33.5	47.8	4.0	30.0	5.3
	Korea	6.4	2.2	93.6	20.0	13.4	49.5
	China	47.5	6.4	52.5	15.0	6.8	24.4
	Hong Kong	14.3	8.9	85.7	20.6	14.5	38.9
	Taiwan	6.8	2.2	93.2	20.0	14.8	51.1

Source: IMF, Coordinated Portfolio Investment Survey

# Japan-EU Collaboration to Support ACMI

- There are large gaps on regulatory capacity and market infrastructure among ASEAN countries; these gaps can be serious obstacles to the process of integration.
- It is vital to provide less-advanced countries with TA that will support their efforts to build capacity and infrastructures.
- Japan and EU can collaborate to take a leading role in coordinating such assistance and filling the gap in funding resources.



# Conclusions

- Japan and EU can strengthen trade and financial cooperation to further promote economic integration in East Asia.
- In particular, efforts should be made to
  - ✓ *reach a high standard FTA agreement that provides a benchmark for Asia's regional FTA.*
  - ✓ *take a leading role in supporting ASEAN capital market integration.*

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